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SUBJECT: Philippines: 2009 Investment Climate Statement, Part One

REF: 08 STATE 123907

¶1. Part Two of PostQs 2009 Investment Climate Statement is transmitted in paragraph 2, in accordance with reftel instructions.

¶2. Begin text:

2009 Investment Climate Statement -- The Philippines

Efficient Capital Markets And Portfolio Investment

The Philippines is open to foreign portfolio capital investment. Foreigners may purchase publicly or privately issued domestic securities, invest in money market instruments, and open peso-denominated savings and time deposits. Portfolio investments in publicly listed firms are, like direct equity investments, constrained by foreign ownership ceilings stipulated under the Constitution and other laws. Although growing, the securities market remains small and underdeveloped, and is not able to offer investors a wide range of choices. Except for a few large firms, long-term bonds and commercial paper are not yet major sources of capital. Secondary trading of publicly-listed stocks is exempt from documentary stamp tax through March 2009.

Some firms classify their publicly listed shares as "A" (exclusively for Filipinos) and/or "B" (for foreigners and Filipinos). While the practice of classifying shares was common until the early 1990s, most newly-listed companies no longer classify shares into "A" and/or "B," because the Foreign Investment Act has since lifted the 40 percent general ceiling previously imposed on foreign investments. However, listed firms engaged in activities where foreign investment caps still apply (i.e., banking, utilities, real estate, exploration of natural resources, etc.) find the classification convenient for compliance purposes.

The equities market is thin (less than 250 listed firms), concentrated, and prone to volatility. During 2008, the ten most actively traded companies accounted for more than 50 percent of trading value and about 40 percent of domestic market capitalization. To encourage publicly listed companies to widen their investor base, the Philippine Stock Exchange (PSE) introduced reforms in April 2006 to include trading activity and free float criteria in the selection of companies comprising the stock exchange index. The 30 companies included in the benchmark index are subject to review every six months. Hostile takeovers are not common, because most company shares are not publicly listed and controlling interest tends to remain with a small group of parties. Cross-ownership and interlocking directorates among listed companies also lessen the likelihood of hostile takeovers.

The July 2000 passage of the Securities Regulation Code strengthened

investor protection by codifying the full disclosure approach to the regulation of public offerings, tightening rules on insider trading, segregating broker-dealer functions, outlining rules on mandatory tender offer requirements, significantly increasing sanctions for violations of securities laws and regulations, and mandating steps to improve the internal management of the stock exchange and future securities exchanges. However, prosecution of stock market irregularities is subject to the usual delays and uncertainties of the Philippine legal system. To improve transparency and minimize conflict of interest, the Code also prohibits any one industry group (including brokers) from controlling more than 20 percent of the stock exchange's voting rights. The Philippine Stock Exchange has yet to fully comply with the 20 percent industry limit, although it has taken steps to reduce brokers' ownership from 100 percent to 41% of the stock exchange.

#### -- CREDIT POLICIES:

Credit is generally granted on market terms and foreign firms are able to obtain credit from the domestic market. However, some laws require financial institutions to set aside loans for certain preferred sectors, which may translate into increased costs and/or credit risks. The Agri-Agra Law (P.D. 717, as amended) requires banks to set aside 25 percent of loanable funds for agricultural credit in general, with at least 10 percent earmarked for programs such as improving the productivity of farmers to whom land has been distributed under agrarian reform programs. To facilitate compliance, alternative modes of meeting the agri-agra lending requirement include low-cost housing, educational and medical developmental loans, and investments in eligible government securities. R.A. 9501, the Magna Carta for Micro, Small and Medium Enterprises requires banks to set aside ten percent of their loans for small-business borrowers. While most domestic banks are able to comply with these targeted-lending requirements, foreign banks find mandatory policies more burdensome for a number of reasons, including their lack of knowledge and experience with these sectors, their constrained branch networks, and constitutional restrictions on ownership of land by foreigners which impede their ability to enforce security rights over land accepted as collateral. In August 2006, President Arroyo signed Executive Order 558 (further expounded by E.O. 558-A), which allows all government agencies to provide credit services regardless of their mandated functions. E.O. 558 repealed E.O. 138 (issued in August 1999), which rationalized and limited the government's role in credit extension activities to make way for a more market-driven, private sector role in micro-finance. The Asian Development Bank, the World Bank, and Philippine micro-finance industry players have expressed serious concern that direct lending by non-financial agencies could lead to government losses caused by corruption and unsound lending decisions. Although E.O. 558 has not been repealed, implementation appears to have been limited thus far to micro-finance lending programs of the Department of Social Welfare and Development targeted to the country's ten poorest provinces.

#### -- BANKING SYSTEM:

The Philippine banking system is dominated by 38 commercial banks that account for nearly 90 percent of total banking system resources. As of the end of September 2008, the five largest commercial banks had estimated total assets of PHP 2,442 billion (equivalent to about \$52 billion), representing 52 percent of total commercial banking system resources. The central bank has worked to strengthen banks' capital base, reporting requirements, corporate governance, and risk management systems. Central bank-mandated phased increases in minimum capitalization requirements and regulatory incentives for mergers have prompted several banks to seek partners. All entities under Central bank supervision are required to adopt Philippine Financial Reporting and Accounting Standards -- patterned after International Financial Reporting and Accounting Standards.

There has been progress in disposing of non-performing assets since President Arroyo signed the Special Purpose Vehicle law in January 2003, which provided fiscal and regulatory incentives to encourage the resolution of non-performing assets through their sale to private asset management companies. Banks were given until May 2008 to conclude notarized agreements to sell their non-performing loans and foreclosed assets to qualify for incentives under the second phase of the law. Total banking sector non-performing assets sold

under the Special Purpose Vehicle law amounted to PHP 152.9 billion (\$3.1 billion), equivalent to almost 30 percent of eligible mid-2002 non-performing assets. Non-performing loans accounted for almost 70 percent of total assets sold. Non-performing loan and non-performing asset ratios of commercial banks - which peaked in October 2001 at 18.3 percent and 14.6 percent respectively - were estimated at 4.0 percent and 4.9 percent, as of the end of September 2008, back to their pre-Asian crisis levels.

Commercial banks' published average capital adequacy ratio (15.5 percent on consolidated basis as of end-June 2008, computed according to the Basel 2 Risk-based Capital Adequacy framework) remains above the central bank's 10 percent statutory limit and the 8 percent internationally accepted benchmark. Philippine banks have limited direct exposure to investment products issued by troubled financial institutions overseas (estimated at less than 2 percent of total banking system resources)..

The General Banking Law of 2000 paved the way for the Philippine banking system to phase in internationally accepted, risk-based capital adequacy standards. In 2007 a revised capital adequacy framework (Basel 2) was adopted. It expands coverage from credit and market risks to operational risks and enhances the risk-weighting framework. Other important provisions of the General Banking Law are geared towards strengthening transparency, bank supervision, and bank management. Remaining impediments to more effective bank supervision and timely intervention include stringent bank secrecy laws, obstacles preventing regulators from examining banks at will, and inadequate liability protection for central bank officials and bank examiners.

The Paris-based Financial Action Task Force continues to monitor implementation of the Philippines' Anti-Money Laundering Act through the Anti-Money Laundering Council to ensure that the Philippines sustains progress. Foreign exchange dealers and remittance agents are required to register with the central bank in order to operate and must comply with various central bank regulations and requirements related to the implementation of the Philippines' anti-money laundering law. The Egmont Group, the international network of financial intelligence units, admitted the Philippines to its membership in June 2005. The Financial Action Task Force Asia Pacific Group conducted a comprehensive peer review of the Philippines in September 2008. Some of the more important Asia Pacific Group concerns include the exclusion of casinos from the scope of current anti-money laundering legislation and 2008 court rulings that inhibit and complicate investigations of fraud and corruption by prohibiting ex-parte inquiries regarding suspicious accounts due to bank privacy laws. The Philippine legislature is considering amendments to the Anti-Money Laundering Act of 2001 to address these issues.

#### -- ACCOUNTING STANDARDS:

The Philippine Securities and Exchange Commission and the Bangko Sentral ng Pilipinas agreed to the full adoption of International Accounting Standards Board-prescribed standards starting in 2005. These standards are now embodied in the Philippine Financial Reporting Standards and Philippine Accounting Standards. However, some companies/industries have been granted temporary exceptions. For example, a central bank circular to implement the Special Purpose Vehicle Act deviates from generally accepted accounting principles by allowing banks to book losses arising from the sale of non-performing assets on a staggered basis. To encourage consolidation, the central bank has also allowed merging institutions to stagger provisions for bad debts. "Non-publicly accountable entities" (i.e., small and medium enterprises and firms that are not publicly listed, that are not debt/securities issuers, that are not engaged in fiduciary activities, or that are not public utilities or essential public service providers) are exempt from the new accounting and financial reporting standards, pending issuance by the International Accounting Standards Board of a separate accounting standard for small and medium enterprises.

The Philippine Financial Reporting Standards Council approved the immediate adoption of amendments issued by the International Accounting Standards Board in October 2008 covering the accounting treatment and disclosure of financial assets. The Board amendments provided guidelines for the reclassification of certain non-derivative financial assets from categories recorded at fair market value to categories recorded at amortized cost, purposely to

help promote confidence in financial markets by tempering the potentially sharp deterioration in balance sheets and incomes from the current global financial turbulence. The Philippine Securities and Exchange Commission and the central bank have issued circulars to implement the amendments. As additional regulatory relief, the central bank also allowed the reclassification, until mid-November 2008, of credit link notes and similar products backed by Republic of the Philippines bonds.

The Philippine Securities and Exchange Commission requires a firm's Chairman of the Board, Chief Executive Officer, and Chief Financial Officer to assume management responsibility and accountability for financial statements. Current rules also require the rotation and accreditation of external auditors of companies imbued with public interest (i.e., publicly listed firms, investment houses, stock brokerages, and other secondary licensees of the Securities and Exchange Commission). The Securities and Exchange Commission's "Guidelines on Accreditation and Reportorial Requirements of External Auditors of Public Companies" instituted a system of accreditation for external auditors of firms that issue securities to the investing public. It also requires client-companies to disclose to the Securities and Exchange Commission any material findings (i.e., fraud or error, losses or potential losses aggregating 10 percent or more of company assets, and indications of company insolvency) within five days of receipt of the external-audit findings. The external auditor is required to make the disclosure to the Securities and Exchange Commission within 30 business days from submitting its audit report to the client-company should the latter fail to comply with this reporting requirement. The regulations require client-auditor contracts to contain a specific provision protecting the external auditor from civil, criminal, or disciplinary proceedings for disclosing material findings to the Securities and Exchange Commission. They also require accredited external auditors to accumulate continuing education credits and to comply with certain operational requirements such as quality assurance procedures and the communication of critical and alternative accounting policies and practices. In 2007, the Auditing and Assurance Standards Council issued new standards on quality control, auditing, review, assurance and related services which outline additional measures and policies for compliance by external auditors to improve independence, objectivity, and completeness of audit work.

A number of the larger local accountancy firms are affiliated with international accounting firms, including KPMG, PricewaterhouseCoopers, Ernst & Young, Deloitte & Touche, BDO Seidman, and Grant Thornton.

#### Political Violence

Terrorist groups and criminal gangs operate in some regions of the country. The Department of State publishes a consular information sheet on the internet at <http://travel.state.gov> and advises all Americans living in or visiting the Philippines to review this information periodically. The Department of State has issued a travel warning to U.S. citizens contemplating travel to the Philippines. The full current text of the warning is available at [http://travel.state.gov/travel/cis\\_pa\\_tw/tw/tw\\_2190.html](http://travel.state.gov/travel/cis_pa_tw/tw/tw_2190.html). The Department strongly encourages Americans in the Philippines to register with the Consular Section of the U.S. Embassy in Manila through the State Department's travel registration website, <https://travelregistration.state.gov/>.

Arbitrary, unlawful, and extrajudicial killings by a variety of actors continue to be a problem. Following increased domestic and international scrutiny, the number of killings and disappearances continue to drop significantly from a peak in 2006. Despite government efforts to investigate and prosecute these cases, many have gone unsolved and unpunished. The 2007 congressional and local elections were generally free and fair but were marred by violence and allegations of vote buying and electoral fraud. On August 11, more than 1.31 million of the 1.52 million registered voters from the six provinces comprising the Autonomous Region in Muslim Mindanao elected a Regional Governor, a Regional Vice Governor, and Regional Legislative District Assemblymen. The Asian Network for Free Elections Foundation noted the government's commitment to make the elections as free and fair as possible. However, election monitors documented allegations of fraud and irregularities in some

localities.

Members of the insurgent group Moro Islamic Liberation Front attacked villages in central Mindanao and killed dozens of civilians in August 2008 after the Supreme Court placed a temporary restraining order on the signing of a preliminary peace accord. The ensuing fighting between government and insurgent forces has led to both combat and civilian deaths and the displacement of thousands of people. While the parties have not yet agreed on a new roadmap for future negotiations, the government has announced its commitment to resume talks.

The New People's Army, the military arm of the Communist Party of the Philippines, remains a threat to the long-term stability of the country. It has not targeted foreigners in recent years, but could threaten U.S. citizens engaged in business or property management activities. It is responsible for general civil disturbance through assassinations of public officials, bombings, and other tactics. It frequently demands "revolutionary taxes" from local and, at times, foreign businesses and business people, and sometimes attacks infrastructure such as power facilities, telecommunications towers, and bridges to enforce its demands. The National Democratic Front, the Communist Party's political arm, has engaged in intermittent but generally non-productive peace talks with the Philippine government.

Other terrorist groups, including the Abu Sayyaf Group and Jema'ah Islamiyah, periodically attack civilian targets in Mindanao or kidnap civilians for ransom.

The Philippines faces no major external threat and enjoys strong relations with the United States. The United States and the Philippines are allies under the 1951 Mutual Defense Treaty, and the U.S. designated the Philippines as a major non-North Atlantic Treaty Organization ally in 2003. The Visiting Forces Agreement, ratified in 1999, provides a framework for US-Philippine military cooperation, including exercises, ship visits, and counter-terrorism cooperation.

#### Corruption

Corruption is a pervasive and longstanding problem in the Philippines. The Philippines is not a signatory of the Organization for Economic Cooperation and Development Convention on Combating Bribery. The Philippines signed the UN Convention against Corruption in 2003, which the Senate ratified in November 2006.

There are a number of laws and mechanisms directed at combating corruption and related anti-competitive business practices. These include the Philippine Revised Penal Code, Anti-Graft and Corrupt Practices Act, and Code of Ethical Conduct for Public Officials. The Office of the Ombudsman investigates and prosecutes cases of alleged graft and corruption involving public officials. The Sandiganbayan (anti-graft court) prosecutes and adjudicates cases filed by the Ombudsman. There is also a Presidential Anti-Graft Commission to assist the President in coordinating, monitoring, and enhancing the government's anti-corruption efforts and to investigate and hear administrative cases involving presidential appointees in the executive branch and government-owned and controlled corporations. Soliciting/accepting and offering/giving a bribe are criminal offenses, punishable with imprisonment (6-15 years), a fine, and/or disqualification from public office or business dealings with the government. However, enforcement of anti-corruption laws has been weak and inconsistent.

The Philippine government has worked in recent years to reinvigorate its anti-corruption drive. However, worsening corruption rankings suggest that efforts have been inconsistent; reforms have not reached a critical mass to improve public perception; are being overshadowed by high-profile cases intermittently reported in the Philippine media; and that other countries have pursued anti-corruption programs more aggressively.

#### Bilateral Investment Agreements

As of December 2008, the Philippines had signed bilateral investment agreements with Argentina, Australia, Austria, Bahrain, Bangladesh, Belgium and Luxembourg, Canada, Cambodia, Chile, China, the Czech

Republic, Denmark, Equatorial Guinea, Finland, France, Germany, India, Indonesia, Iran, Italy, Japan, Republic of Korea, Kuwait, Laos, Mongolia, Myanmar, Netherlands, Pakistan, Portugal, Romania, Russian Federation, Saudi Arabia, Spain, Sweden, Switzerland, Taiwan, Thailand, Turkey, United Kingdom, Venezuela, and Vietnam. The general provisions of the bilateral investment agreements include: the promotion and reciprocal protection of investments; nondiscrimination; the free transfer of capital, payments and earnings; freedom from expropriation and nationalization; and, recognition of the principle of subrogation.

**Taxation:** tQ Philippines has a tax treaty with the United States for the purpose of avoiding double taxation, providing procedures for resolving interpretative disputes, and enforcing taxes of both countries. The treaty also seeks to encourage bilateral trade and investments by allowing the exchange of capital, goods and services under clearly defined tax rules and, in some cases, preferential tax rates or tax exemptions.

**Most Favored Nation Clause (royalties):** Pursuant to the most favored nation clause of the Philippine-U.S. tax treaty, U.S. recipients of royalty income may avail of the preferential rate provided in the Philippine-China tax treaty, which went into effect in January 2002. That treaty allows a lower rate of 10 percent with respect to royalties arising from: the use of (or right to use) any patent, trademark, design, model, plan, secret formula, or process; or, the use (or right to use) industrial, commercial, and scientific equipment, or information concerning industrial, commercial, or scientific experience.

**Permanent establishments:** A foreign company that renders services to Philippine clients without setting-up a branch office is considered a "permanent establishment" liable to pay Philippine taxes if the services rendered to a Philippine client requires its personnel stay in the country for more than 183 days (for the same or a connected project) in a twelve-month period. Bureau of Internal Revenue rulings on the taxation of permanent establishments have been inconsistent. In some rulings, the Philippine government has applied the corporate income tax rate on net taxable income, a treatment that applies to resident foreign corporations. In others, it has applied the corporate income tax rate on gross income, a treatment that applies to non-resident foreign corporations.

**Tax Treaty Relief Rulings:** To use preferential tax treaty rates and treatment, a tax treaty relief ruling must be secured from the Bureau of Internal Revenue's International Trade Affairs Department. According to tax lawyers, the process can be subject to delay, with some tax treaty relief applications reportedly pending for from several months to over a year.

**Inter-Company Transfer Pricing:** The Tax Code authorizes the Bureau to allocate income or deductions among related organizations or businesses, whether or not organized in the Philippines, if such allocation is necessary to prevent tax evasion. The Bureau has yet to finalize draft regulations on transfer pricing, a contentious issue between multinational companies and the Bureau, but declared in early 2008 that, as a matter of policy, it subscribes to the Organization for Economic Cooperation and Development's transfer pricing guidelines. In anticipation of the release of the final Bureau regulations, multinational companies have undertaken, or are preparing, transfer pricing studies and/or benchmarking for their related-party transactions.

**Value Added Tax:** The GRP implemented an expanded value added tax law in November 2005 to increase revenues. The amendments to the Tax Code reduced the list of VAT-exempt goods and services (including exemptions previously enjoyed by the fuel and electricity sectors). A 12 percent tax rate applies on domestic sales of goods and services and on imports. The 2005 amendments to the Tax Code also temporarily raised the corporate income tax rate from 32 percent to 35 percent until the end of 2008. A lower 30 percent corporate income tax rate took effect in January 2009.

**Optional Standard Deduction:** Republic Act 9504 -- issued in June 2008 mainly to provide tax relief to minimum wage earners and individual taxpayers -- included a provision allowing domestic and foreign resident companies subject to the regular corporate income tax to opt for a 40 percent standard deduction against gross sales/receipts. Prior to R.A. 9504, the optional standard deduction (previously set at 10 percent) applied only to the self-employed and those engaged in the practice of professions.

**Stock Transfer Tax:** A February 2007 Bureau of Internal Revenue ruling involving a Singaporean investor contradicted previous rulings which exempted from stock transaction tax sales of shares in publicly-listed companies in the stock exchange by virtue of tax treaty provisions granting exemption from capital gains tax. In 1994, amendments to the Tax Code replaced a capital gains tax imposed on shares sold through the stock exchange with a stock transfer tax. The February 2007 ruling concluded that a Singapore resident does not qualify for tax exemption under the Singapore-Philippines Tax Treaty for shares sold through the stock exchange because stock transfer tax, as an ad-valorem transaction tax and not an income tax, cannot be considered an identical or substantially similar tax on income in place of the capital gains tax imposed under the previous law. This recent interpretation could be used by the Bureau of Internal Revenue as a precedent for resolving future tax treaty relief applications by U.S. and other foreign investors.

**International Financial Reporting Standards:** Bureau of Internal Revenue rules/regulations for tax accounting purposes have not been fully harmonized with the recording and recognition of transactions for financial accounting and reporting purposes prescribed under Philippine Financial Reporting Standards (patterned after standards issued by the International Accounting Standards Board). The disparities between reports for financial accounting versus tax accounting purposes can be an irritant between taxpayers and tax collectors. The Bureau of Internal Revenue requires taxpayers to maintain records reconciling figures presented in financial statements and income tax returns.

#### OPIC And Other Investment Insurance Programs

The Philippines currently does not provide guarantees against losses due to inconvertibility of currency or damage caused by war. The Overseas Private Investment Corporation can provide U.S. investors with political risk insurance for expropriation, inconvertibility and transfer, and political violence, based on its agreement with the Philippines. The Philippines is a member of the Multilateral Investment Guaranty Agency.

#### Labor

**Labor Force:** American managers operating in the Philippines will find a large, highly motivated work force that is easy to recruit and train. The July 2008 labor force survey revealed that the labor force is estimated at 37.3 million. In 2008, the official unemployment rate increased to 7.4 percent from 6.3 percent in 2007. This figure includes employment in the informal sector and does not capture the substantial underemployment in the country.

Plant managers are generally pleased with Filipino workers and often cite productivity and receptivity to training as positive factors. The existence of Special Economic Zones and low wages are other positive factors for investors.

**High Trainability:** Literacy in both English and Filipino is relatively high. However, English proficiency appears to be declining. The Department of Education, under its National English Proficiency Program, continues its effort to strengthen English language training including through school-based mentoring programs for public elementary and secondary school teachers, aimed at improving public school teachers' English language skills and competence.

**High productivity:** Employers find that Filipino workers generally respond well to productivity goals and wage incentives for increasing their output. Exceptions can often be attributed to lack of equipment, poor training, and job insecurity.

**Special Economic Zones:** Special Economic Zones continue to play a significant role in attracting new investors to the country. The zones normally include their own labor centers for assisting investors with recruitment, coordinating with the Department of Labor and Employment and Social Security Agency, and mediating labor disputes. The zones have helped produce rapid growth in new jobs as both Philippine and foreign firms seek the tax and other advantages of these areas devoted to fostering export industries. As of November 2008, an estimated 1.53 million employees were working in zones under the Philippine Economic Zone Authority

(www.peza.gov.ph).

**Low Wages:** Multinational managers report that their total compensation packages tend to be comparable with those in neighboring countries, a good value for their mid-level management and skilled staff in the Philippines. In the call center industry, average labor cost is between \$1.60 and \$1.90 per hour.

Regional Wage and Productivity Boards meet periodically in each of the country's 16 administrative regions to determine minimum wages. In recent years, the regional boards have adjusted the minimum wage rate about once annually. The National Capital Region Board sets the national trend. As of August 2008, the daily minimum wage in Metro Manila was pegged between PHP345 and PHP382 (\$7 to \$8). While the Philippine government maintains a minimum wage of PHP382 per day for what it calls "non-agricultural workers," employees in agriculture, private hospitals, retail service, and manufacturing in fact receive PHP345. Cost of living allowances are given across the board. Most other regions set their minimum wage at about PHP62 to PHP149 less than Manila's. Some provinces in the Autonomous Region of Muslim Mindanao and Bicol region have daily minimum wages as low as PHP 196. The regional boards grant various exceptions, depending on the type of industry and number of employees at a given firm.

**Labor-Management Relations:** The Constitution enshrines the right of workers to form and join trade unions. The mainstream trade union movement recognizes that its members' welfare is tied to the productivity of the economy and competitiveness of firms. The impact of globalization and free trade continues to force unions to modify their bargaining and organizing approach. Frequent plant closures have made many unions more willing to accept productivity-based employment packages. The number of firms using temporary contract labor continues to grow.

The number of strikes has declined from 25 in 2004 to 5 strikes in 2008, through September. There are 17,105 recognized unions, with a membership of more than 1.9 million workers (about 5 percent of the workforce). As of June 2008, 1,437 unions have existing collective bargaining agreements that cover 218,639 workers. Mainstream union federations typically enjoy a good working relationship with employers, including those in Special Economic Zones.

In May 2007, a new labor law lowered the requirements for union registration. Under the new law, unions tied to federations are no longer required to maintain a minimum membership of 20 percent of the workers in a bargaining unit. However, independent unions are required to meet the 20 percent membership requirement. By the end of December 2008, however, the Department of Labor and Employment had not yet issued the required implementing rules and regulations for the new law to take effect.

**Worker Rights:** Although the Philippines is a signatory to all International Labor Organization conventions on worker rights, it is not in full compliance with all of their requirements. Illegal discovery tactics and dismissal of union members are alleged as barriers to organization. The quasi-judicial National Labor Relations Commission reviews allegations of intimidation and discrimination in connection with union activities, although effectiveness of enforcement is reportedly questionable. In cases involving the national interest, which can include cases where companies face strong economic or competitive pressures, the Secretary of the Department of Labor and Employment has the authority to end strikes and mandate a settlement between the parties. Although labor laws apply equally to special economic zones, relatively few unions exist in them, to the consternation of many trade union leaders.

Violation of minimum wage standards is common. As of March 2008, 18 percent of the 13,147 commercial establishments inspected by the Philippine Department of Labor and Employment were not in compliance with the prevailing minimum wage. However, the Department estimates that the actual percentage of non-compliant businesses may be much higher. Non-payment of social security contributions, bonuses, and overtime is particularly common. The law provides for a

comprehensive set of occupational safety and health standards, although workers do not have a legally protected right to remove themselves from dangerous work situations without risking loss of

employment. The Department of Labor and Employment has responsibility for safety inspection, but a severe shortage of inspectors makes enforcement extremely difficult. There have been instances of forced labor in connection with human trafficking.

#### Foreign Trade Zones/Free Trade Zones

The Special Economic Zone Act (R.A. 7916, 1995) grants preferential tax treatment to enterprises located in special economic zones (also referred to as ecozones). Ecozones include export processing zones, free trade zones, and certain industrial estates. The Philippine Economic Zone Authority manages five government-owned export-processing zones and administers incentives available to firms located in more than 170 privately owned and operated zones, technology parks and buildings. Any person, partnership, corporation, or business organization, regardless of nationality, control and/or ownership, may register as an export processing zone enterprise with the Authority. Enterprises located in ecozones that are designated export processing zones are considered to be outside the customs territory of the Philippines and are allowed to import capital equipment and raw material free from customs duties, taxes, and other import restrictions. Goods imported into free trade zones may be stored, repacked, mixed, or otherwise manipulated without being subject to import duties. Goods imported into both export processing zones and free trade zones are exempt from the GRP's Selective Preshipment Advance Classification Scheme. While some ecozones have been designated as both export processing zones and free trade zones, individual businesses within them are only permitted to receive incentives under a single category.

Incentives for firms in export processing and free trade zones include: income tax holiday or exemption from corporate income tax for four years, extendable to a maximum of eight years; after the expiration of the income tax exemption, a special five percent tax rate on gross income in lieu of all national and local income taxes (with the exception of land owned by developers, which is subject to real property tax); tax and duty-free importation of capital equipment, raw materials, spare parts, supplies, breeding stocks, and genetic materials; exemptions from wharfage dues, export taxes, imposts and other fees; a tax credit on domestic capital equipment; tax credits on domestic breeding stocks and genetic materials; additional deductions for incremental labor costs and training expenses; unrestricted use of consigned equipment; remittance of earnings without prior approval from the central bank; domestic sales allowance equivalent to 30 percent of total export sales; permanent resident status for foreign investors and immediate family members; permission to hire foreign nationals; exemption from local business taxes; and simplified import and export procedures.

The Philippine Economic Zone Authority's Guidelines for the Establishment and Operation of Information Technology Parks defines information technology as a collective term for various technologies involved in processing and transmitting information, which include computing, multimedia, telecommunications, and microelectronics. Information technology parks located in the National Capital Region (Metropolitan Manila) may serve only as locations for service-type activities, with no manufacturing operations. As of December 2008, there were more than 170 economic zones operating in the country under the Authority, of which 5 are government-owned ecozones located in Mactan, Bataan, Baguio, Cavite, and Pampanga. Another 88 have been approved by the Authoeirt but are not yet operational. Moreover, there are 5 zones under the Bases Conversion Development Authority, namely: Subic Bay Freeport and Special Economic Zone; Clark Special Economic Zone; John Hay Special Economic Zone; Poro Point Special Economic and Freeport Zone; and, the Morog Special Economic Zone. Two other privately-owned ecozones are independent of Authority oversight: the Zamboanga City Economic Zone and Freeport, located in Zamboanga City, Mindanao; and the Cagayan Special Economic Zone and Freeport, covering the city of Santa Ana, Cagayan Province, and adjacent islands. The incentives available to investors in these zones are provided for by R.A. 7903 and 7922, respectively, and are very similar to those provided by the Philippine Economic Zone Authority under R.A. 7916.

The economic zones located inside the two principal former U.S. military bases in the Philippines are independent of the Philippine Economic Zone Authority and subject to separate legislation under the Bases Conversion Development Authority (created under R.A.

7227). These are the Subic Bay Freeport Zone in Subic Bay, Zambales, and the Clark Special Economic Zone in Angeles City, Pampanga. Firms operating inside the zones are exempt from import duties and national taxes on imports of capital equipment and raw materials needed for their operations within the zone. Both zones are managed as separate customs territories. Products imported into the zones are exempt from the GRP's Selective Preshipment Advance Classification Scheme, with the exception of products imported for sale at duty-free retail establishments within the zones. Firms operating in the zones are required to pay only a five percent tax based on their gross income. Both zones have their own international airports, power plants, telecom networks, housing complexes, and tourist facilities.

#### -- CAPITAL OUTFLOW POLICY:

Outward capital investments from the Philippines do not require prior central bank approval when the outward investments are funded by withdrawals from foreign currency deposit accounts; the funds to be invested are not purchased from the banking system; or, if sourced from the banking system, the funds to be invested do not exceed \$30 million per investor per year. Outward investments exceeding \$30 million funded with foreign exchange purchases from the local banking system are subject to prior central bank approval and registration. Applications to purchase foreign exchange from the local banking system for overseas investments should be accompanied by supporting documents and a written undertaking to inwardly remit and sell for pesos to authorized agent banks the dividends, earnings, and divestment proceeds from the outward investments. Current regulations require that the foreign exchange proceeds from profits/dividends and capital divestments from such outward capital investments be remitted within 15 banking days from receipt overseas and sold for pesos to authorized banks within three banking days from receipt in the Philippines.

#### Foreign Direct Investment Statistics

The Securities & Exchange Commission, Board of Investments, National Economic and Development Authority, and the Bangko Sentral ng Pilipinas each generate their own respective direct investment statistics. Central bank data (which records actual rather than approved investments based on balance of payments concepts/methodologies, and which is readily available in US dollar terms) is widely used as a convenient and reasonably reliable indicator of foreign investment stock and foreign investment flows. The Central bank publishes annual data on net foreign direct investment flows broken down by country and by industry. The central bank is currently working to improve measurement of foreign direct investment stock.

The formatted tables have been e-mailed to the Department separately. Those needing a copy may request one from the Economic Section at Embassy Manila at [RovinskyDJ@state.gov](mailto:RovinskyDJ@state.gov).

Kenney